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The MORTGAGE BANKER

VOL. 7—No. 8 MAY, 1947

What Does It Cost to Service Loans?

This writer, one of the best-informed men in the U. S. on mortgage lending, tells you his idea and says that the servicing rate prevailing today is not adequate

By HORACE RUSSELL

THERE has been a great deal of discussion of the cost of servicing mortgages but not very much cost accounting. This is written to suggest the wisdom of some accurate cost accounting on this subject and to point out some significant facts and conclusions.


Horace Russell

In the great and glorious 1920's we had a great many mortgage servicing organizations which rendered substantial service in placing and merchandising mortgages and some, but not complete, mortgage servicing. They received certain fees and commissions in placing and merchandising mortgages which temporarily appeared to make them prosperous; they thought it was adequate to enable them to make and service mortgages. I find no adequate, accurate records anywhere but it is believed that these mortgage servicing operators received, in one form or another, approximately 1 per cent per annum. Many of them made five-year loans and charged a 5 per cent cash commission or service charge in advance. Nearly all of them lost money and a great many went broke. My conclusion was, and is, that mortgages cannot be made and serviced for 1 per cent per annum.

HOLC made more than one million mortgages involving more than three billion dollars. It charged the borrower for actual cost of appraisal, title evidence, survey (when necessary), loan closing and recording, and this came to an average of a little more than 1 per cent. In addition, I estimate that the cost to it of putting the business on its books in great volume exceeded 1 per cent. Its early operations are not a fair criterion of mortgage servicing cost because of the character of loans which it took in the beginning and because of economic conditions. However, from 1941 to 1945, it appears that its ratio of operating expense to mortgages and contracts outstanding is a fair criterion of the cost of mortgage servicing. It will be noted in the table on page 2 which cites the official authority, that its mortgage servicing cost was 1.1 per cent in 1941, 1 per cent in 1942, .8 per cent in 1943, .8 per cent in 1944 and .7 per cent in 1945. It should be pointed out in this connection that what little real estate it had on hand

Here are some of the thought-provoking statements you will find in this article by the general counsel of the United States Savings and Loan League written for THE MORTGAGE BANKER at the request of PRESIDENT HOLLYDAY:

There seems to be no accurate cost accounting figures as to the cost of mortgage servicing. . . . The most accurate figures available are those taken from HOLC's experience from 1941 to 1945.

The net cost of mortgage servicing is about 1 per cent per annum . . . my conclusion is that mortgages cannot be made and serviced for 1 per cent. . . .

The savings and loans are spending about a half of their operating expense in acquiring and servicing mortgage loans.

The mortgage servicing contract rate prevailing today is inadequate and at the first approach of hard times, servicing agents will be losing money daily.

These statements ought to be enough to inspire anyone interested in mortgage lending to go right on through the article and read what Mr. Russell's conclusions are on servicing.

during this period was carried separately and real estate expense was charged to real estate and not included in operating expenses. It must be understood that HOLC was adequately financed many years ago and during the years in question, had no substantial expense within its "operating expenses" on account of its outstanding bond issues. It must be understood, also, that HOLC has the free use of the mails; in a monthly amortized mortgage servicing operation, this is a considerable item. It has $200 million of government capital upon which it is required to pay no dividend. It uses some free government office space and pays no taxes (except on real estate, which is charged to real estate and not to operating expenses). These figures, which are more fully reflected in the tabulation, are perhaps the most accurate figures available as to the cost of mortgage servicing. A very large volume of mortgages is involved. The mortgages are well-seasoned. While HOLC is a wholly-owned government corporation, at the same time it has been well and economically administered as a business corporation. Therefore, if any adjustment must be made in these figures, it would have to be upward to be applied to private business which has no free use of the mail, no free capital, no free office space and must pay taxes. If economic conditions became worse than they were in the years 1941 to 1945, inclusive, the cost of mortgage servicing would increase. I think the net cost of mortgage servicing is about 1 per cent per annum.

HOLC OPERATING EXPENSES

Fiscal Years Ending June 30

Year	Mortgages and Contracts Outstanding As of June 30	Operating Expenses*	Percentage of Operating Expenses to Mortgages and Contracts
1941	$1,870.305,000	$20,945,000[1]	1.1%
1942	1,675,888,000	16,086,000[2]	1.0
1943	1,441,153,000	10,836,000[2]	0.8
1944	1,220,106,000	9,368,000[3]	0.8
1945	964,616,000	6,342,000[4]	0.7

OPERATING EXPENSES ALL SAVINGS AND LOAN MEMBERS FEDERAL HOME LOAN BANK SYSTEM

Years Ending December 31**

Year	Mortgages and Contracts Outstanding As of June 30	Operating Expenses*	Percentage of Operating Expenses to Mortgages and Contracts
1941	$4,095,550,000	$62,156,400	1.5%
1942	4,171,060,000	67,406,600	1.6
1943	4,203,377,000	69,270,200	1.6
1944	4,402,470,000	76,000,100	1.7
1945	4,930,855,000	85,825,500	1.7

*Property expense is not included.
[1]FHLBB Report (9th Annual, p. 266).
[2]Report of John H. Fahey to the Congress of the U. S., January 31, 1944, Exhibit A.
[3]FHLB Adm. (12th Annual), p. 68.
[4]Calendar year, 1945. 4th Annual Report NHA, Part 2, p. 27.
**FHLB Adm. "Combined Fin'l. Statements for Members of the FHLB System."

In the years 1941 to 1945, inclusive — prosperous years — the savings and loan members of the Federal Home Loan Bank System held more than $4 billion of mortgages and the percentage of operating expense to mortgages and contracts was 1.5 per cent in 1941, 1.6 per cent in 1942, 1.6 per cent in 1943, 1.7 per cent in 1944 and 1.7 per cent in 1945, as is more fully shown in the tabulation which cites the authority for these figures. Again, I know of no accurate cost accounting figures as to the cost of mortgage servicing. However, I am very well acquainted with the savings and loan business; and it is my opinion that the business spends about one-half of its operating expense in the acquisition of savings and investment funds and the servicing of them and about one-half in the acquisition of mortgage loans and the servicing of them. Most such associations, as in the case of most other mortgage lenders, charge the initial cost of putting mortgages on the books to the borrower so that this amount should not be properly included in their operating expenses. Therefore, I conclude that the naked, actual cost of mortgage servicing to savings and loan associations is between three-fourth of 1 per cent and 1 per cent. And, as some of us know, savings and loan associations and cooperative banks are very economically operated. It is very doubtful that any other type of mortgage institution can meet or beat this cost of mortgage servicing. Again, I think that the legitimate cost of mortgage servicing in prosperous times and hard times will equal or exceed 1 per cent per annum.

I fear that many mortgage bankers, commercial banks and others are today living off of initial service charges and contract to service mortgages at ½ per cent or ¾ per cent with the false hope that they are building up an adequate income for the future. It would be much better for all concerned if mortgage servicing contracts were made upon a basis which would stand up and which would provide adequate service.

My inescapable conclusion is that the mortgage servicing contract rate prevailing today is inadequate. At the first approach of hard times, mortgage servicing agents will be losing money every day. In turn, mortgage purchasers will find themselves with mortgages secured by properties widely scattered, with no adequate means of servicing. It follows that this will be bad for the mortgage market, for the real estate market and for our entire economy. It would be wise to consider today not only prosperous times *but also hard times.*

A Life Company Official Sizes Up City Loans

By H. E. HANDFORD

IN ATTEMPTING to discuss in these pages the lending policy of an insurance company purchasing loans from correspondents, I think I should first try to answer several questions. Where will we lend? What type of security will we lend on — and to whom? How will we lend? These may appear to be easy questions, but to a company investing trust funds of policyholders, they are all $64 questions.

Where will we lend?

In determining locations in a particular city, we consult our correspondent and obtain his recommendation. His experience will aid us in our analysis of the territory. The desirable neighborhoods will then be classified as to price-range and age. We will probably want to avoid pioneering to any great extent; but new sections will be added from time to time when characteristics are satisfactorily known.

H. E. Handford

What will we lend on?

We will require that our security conform to standards of sound construction. It should have a suitable exterior appearance and interior plan and be in good condition. We will probably express a preference for homes not over 25 years of age—but we also must remember that effective age is important. Some older homes in sound locations have had obsolenscence remedied to a large extent by remodelling of kitchens and bathrooms and modernization of heating plants. We have no interest in mansion-type or estate properties. The reason is obvious when we consider cost of upkeep, taxes—and limited marketability.

To whom will we lend?

Briefly, the matters which we will consider in underwriting the borrower are such things as age, occupation, income, moral and financial repsonsibility and the reason for borrowing. Certain ratios involving the borrower's income and loan payments may be set as guides for our correspondent but, in the final analysis, credit underwriting must be a matter of good judgment based on adequate information.

How will we lend?

We certainly must be competitive in such matters as interest rate and terms of the loan. We will offer several types of loan plans — monthly payment, quarterly payment and even semi-annual payment, although, in the last several years, there have been very few requests for the latter. The maximum amount of our loan will vary depending on the size of the city in which we are lending. However, it probably will not exceed $15,000 unless the margin of security is somewhat greater than that ordinarily required. As to minimum amount, it is questionable whether loans below $3000 are profitable to a lender operating at a distance through correspondents—but we should keep an open mind and be willing to consider, as an accommodation to our correspondent, loans down to, say, $2000 minimum.

So far as prepayment privileges are concerned, it is desirable from the lender's standpoint, to obtain a protective option and, at the same time, permit the borrower to make certain excess payments. In my opinion, the one-fifth option, which permits 20 per cent additional principal payments in any one year, meets this requirement. However, a company must be prepared to make some modification by either permitting payment with a bonus or granting a full open option if necessary to meet competition.

I believe all loan correspondents will agree that a flexible policy is of great importance in lending operations. Hide-bound rules will lose good business both for the insurance company and the correspondent. On the other hand, to maintain a flexible policy the correspondent must assume his responsibilities. No satisfactory relationship can be built between the lender and the correspondent on the principle "Let the Buyer Beware"!

How do FHA's fit into the picture for insurance company investment?

I think that the experience on Title II, Section 203 loans has been such that from the standpoint of location, construction, credit underwriting of the borrower and loan terms we can say that these loans make excellent investments for an insurance company. In other words, the FHA program conforms to good lending practice and the added risk of 80 and 90 per cent loans is adequately protected by the FHA insurance. Insurance companies have sought FHA loans under Title II and will continue to do so. However, an important consideration is the net return which we may realize when we

Someone reading THE MORTGAGE BANKER for the first time might logically expect that we had published in the past many articles of the kind which MR. HANDFORD contributes here but the truth is we haven't. It is a rather basic type of piece for this magazine because the author takes you right through his thinking and policy regarding the different types of city loans today. He describes how his company regards FHA Title II loans, 608's, and G.I.'s and gives his opinion about 25-year maturities and G.I. down payments. It's a good case study of how one life company is looking at city loans at the moment and can be compared with your own present-day experience. Mr. Handford is manager of city loans for Bankers Life Company in Des Moines.

take into account the premium and service fee paid the correspondent and the average life of our FHA account. Open-option FHA loans have a very bad habit of not staying on the books —especially in an active real estate market.

FHA Experience Good

What about Section 603 loans under Title VI? Under Title VI, certain fundamentals of good loaning practice were weakened in order to provide housing for war workers. The locations in some instances were quite minimum and the original corporate borrowers limited as to financial strength. However, to strengthen the program from the investors point of view, the term of the debentures was shortened to ten years. Waste was hedged to the extent of $100, and foreclosure costs were included in the insurance up to $75 or two-thirds of the expenditure whichever was greater. These features were sufficiently attractive to induce most lenders to invest in Title VI loans.

The experience on Title VI loans has been very good for rising costs and continued housing shortages have strengthened the loans materially. Under the current Title VI program, which follows substantially the wartime pattern with the recognition of "necessary current cost" because of the housing emergency, it would appear that the protection afforded the investor is quite adequate and the only problem will be one of satisfactory net return taking into consideration the rate of interest of 4 per cent and the premium and service fee paid the correspondent. Needless to say, we will cooperate to the fullest extent with the FHA in its new rental housing program.

Now as to our most recent type of home loan — G.I. loans under the Servicemen's Readjustment Act. Regardless of what one may think of the economic timing—with a vast reservoir of credit made available in a real estate market fraught with shortages—it was the intention of the American people through Congress, to give the veteran every opportunity to compete in the existing market for a home. Congress seriously considered having the government loan the money direct at a very low rate of interest and I believe 3 per cent was mentioned. If such a law had been enacted, investors probably would have avoided a few minor headaches, but it seems to me that we would have suffered a much more severe headache with the government in the direct loan business at low rates which could have eventually demoralized the mortgage loan market. Therefore, I believe that insurance companies and other lenders should cooperate to the fullest extent in an endeavor to make the plan work.

Can we consider the guarantee adequate from the standpoint of protection against principal loss? I believe that it is the consensus of opinion of students of the Act that, barring an economic catastrophe, the measure of protection is very good. The protection afforded enables insurance companies to make high percentage loans with little chance of actual principal loss and the responsibilities of the lender are not any greater than a prudent lending institution would exercise.

Gives G.I. Loan Policy

I think a realistic policy on G.I. loans requires that the lender consider 100 per cent loans up to say, a maximum of $10,000 with a guarantee of 50 per cent or $4,000, whichever is less. This leaves a maximum of 60 per cent in the case of a $10,000 loan as the amount at risk, and 50 per cent of the loan if it is $8,000 or less. We have, therefore, a reasonable margin below the basis on which conventional loans are generally made. Such a margin is desirable because of the difference today between "reasonable value" as defined by the V.A. and what we think of as value for long-term mortgage purposes, based on stabilized costs. In the actual practice of underwriting a G.I. loan as to amount, the lender can first deduct the guarantee from the loan and determine the amount at risk. He can then decide whether he would make a conventional loan in the amount at risk, predicated on what he believes to be the long-term mortgage value for the security. Sometimes a down-payment helps to qualify the loan on the basis of this analysis.

G.I. lending has, to a certain extent, broadened the territory in which lenders have operated for conventional loans. The higher dollar amount of the G.I. loan enables the lender to profitably make such loans on more modest types of property whereas a conventional loan might have been too small to be profitable. The quality of construction on some of the newer homes has not been quite up to the standard for conventional loans, and it has been necessary to watch construction specifications closely to make sure that we do not go below certain minimum standards. We hope it is only a temporary problem. Many of the loans submitted have been on older houses and this too has presented somewhat of a problem in underwriting.

A New Borrower Class

In making G.I. loans, the lender also has been confronted with an entirely different class of borrower—most of the borrowers being younger men with little or no assets—and it has been much more difficult to underwrite the credit. It is necessary to give very careful attention to the veteran's present income and the stability and permanence of such income. It is not consistent with good lending practice nor is it any favor to a veteran to lend him money beyond his ability to repay. Certain proven guides and accepted ratios applied judiciously are quite helpful in determining whether a borrower has a reasonable chance of meeting his obligations. For example, monthly carrying charges of principal, interest and taxes should bear a proper relation to annual income and most of us think that this should not exceed 25 per cent. Similarly the value of the property should be less than three times the annual income. While these rules cannot apply blindly, and the nature of the borrower's family responsibility and other obligations must be taken into consideration, they do serve as warning signals that the veteran may be over-burdening himself. In underwriting the borrower's credit, it is highly important to analyze carefully his fixed obligations such as installment payments for auto and furniture, to be sure his required payments are not too heavy an obligation. Often it is desirable that he use his available cash to purchase his furniture outright to avoid comparatively large monthly

(Continued on page 7, column 2)

Third 1947 MBA Clinic Set for Kansas City May 8-9; Panel Forums Feature Program

If you missed MBA's Chicago Clinic and won't be able to get to New York for our second regional meeting, our third Mortgage Clinic in Kansas City May 8 and 9 will be your last chance at one of our regional conferences this year. The Kansas City Clinic will be preceded by the regular Spring meeting of the board of governors May 7.

The Clinic itself will be considerably different from the first two. The program is entirely panel discussions with a much wider range of subjects to be reviewed and a larger number of speakers than before. Hotel reservations should be made directly with Marshall H. Dean, Hotel President. Here is how our program lines up at the moment:

First morning: General Theme: "G. I. Lending." Moderator — Earl Linn, vice president, The Weitz Investment & Realty Company, Des Moines.

Panel Members are:

Walter T. Robinson, director, Regional Loan Guarantee Office, Veterans Administration, Des Moines; John H. Armbruster, Secretary, Community Federal Savings and Loan Association, St. Louis; Walter C. Nelson, Vice President, Eberhardt Company, Minneapolis.

Neil W. Hall, The First Trust Company of Lincoln, Lincoln, Nebraska; Harold Schulenberg, Builder, Kirkwood, Mo.; Grant Torrance, Treasurer, Business Men's Assurance Company of America, Kansas City; and Jonas Graber, FHA Director for Kansas, Topeka; Samuel E. Neel, MBA Washington Counsel, Washington, D. C.

First afternoon: Forum on Rental and Cooperative Housing. Moderator —Earl Linn.

"FHA Policy Respecting Rental Housing Under Section 608 of Title VI" by Franklin D. Richards, Assistant Administrator, FHA, Washington, D. C.

"How to Obtain and Negotiate FHA 608 Loans" by H. B. Gibbs, Loan Supervisor, The National Life & Accident Insurance Co., Inc., Nashville.

"Financing Cooperative Housing" by Edgar N. Greenebaum, President, Greenebaum Investment Company, Chicago.

"Reducing Costs Through New Construction Methods" by John T. Holsman, Architect, Chicago.

7:00 P.M. Dinner Meeting

Presiding — Byron T. Shutz, President, Herbert V. Jones & Company, Kansas City, Past President Mortgage Bankers Association of America.

Speaker — Claude L. Benner, Vice President, Continental American Life Insurance Company, Wilmington, Del.

Second morning: General Theme: "Building Construction and Costs." Moderator — Aubrey M. Costa, Vice President, Southern Trust & Mortgage Company, Dallas.

Panel Members are:

Perron D. McElroy, Secretary, Building & Construction Trades Council, Kansas City; Frank Spink, President, Builders Association of Kansas City, and Ben Wileman, Builder, Oklahoma City, Oklahoma.

David H. Powell, District Director, FHA, Kansas City; Keith W. Dancy, Loan Guarantee Officer, Veterans Administration, Kansas City.

Second afternoon: General Theme: "How to Improve Business Practices." Moderator—Byron T. Schutz, President, Herbert V. Jones & Company, Kansas City.

Panel Members and Subjects are:

"What Promotion and Advertising Methods Show the Most Favorable Returns" by Dale M. Thompson, Vice President, City Bond & Mortgage Co., Kansas City.

"The Mortgage Man's Relationship with Builders" by J. Wilson Swan, Vice President, Braniff Investment Company, Oklahoma City.

"Developing Better Office Personnel" by Rupert I. Hall, President, Hall Investment Company, Tulsa.

"Short Cuts in Office Operations" by R. S. Brewer, Vice President, The Wheeler Kelly Hagny Trust Company, Wichita.

"How Can the Investor Cooperate to Improve the Company-Correspondent Relationship" by W. Braxton Ross, Vice President, Morrison and Morrison, Inc., Denver.

"How Can the Correspondent Cooperate to Improve the Company-Correspondent Relationship" by A. A. Zinn, Vice President, The State Life Insurance Company, Indianapolis, and Past President, Mortgage Bankers Association of America.

WRITE DIRECT FOR HOTEL RESERVATIONS

MBA has *no* special housing bureau set up for the Kansas City Clinic as we had for the first two. Write direct to Marshall H. Dean, Assistant General Manager, Hotel President, specifying the accommodations you want— and do so immediately because we're expecting a large crowd.

SEES LOAN SHORTAGE FOR ANOTHER 8 YEARS

A survey made by the Savings Banks Trust Co., owned by New York's 131 mutual savings banks, indicates that the volume of mortgages available to these banks during the next eight years will probably be inadequate for their requirements.

The survey was undertaken to determine what the available mortgage volume would be "in the predictable future," according to the *American Banker*.

The conclusions reached are based on construction costs considerably deflated from present levels, but stabilized at about one-third above 1939 costs. They are also based on the present rate of mortgage debtors' amortizations and on a 3 per cent rate of growth of the banks' deposits during the next eight years.

Dr. Irving Bussing, economist for the company, pointed out that in New York State only 28 per cent of the people live in their own homes, compared to 40 per cent average throughout the country. This means, he said, that 72 per cent of the people of the State must depend on rental housing, but that risk takers who might venture into construction of rental housing are re-

(Continued on page 7, column 3)

Outcome of New WET Bill Likely to Be Big Factor in Shaping Future Loan Business

IT ISN'T likely that many mortgage men who opposed the original WET bill will change their minds about the new one. Our March 17th *Washington Letter* analyzed it in detail and pointed out that some of its principal features such as yield insurance and public housing remained unchanged. Senator Taft himself told the *Commercial and Financial Chronicle* that it's "substantially the WET bill." He observed that in the yield insurance provisions, the authors had some doubt whether they are in a practicable form to be used by insurance companies. "We hope insurance companies may suggest improvements to make it likely that they will avail themselves of the bill's terms," he said.

MBA's study last year clearly indicated that the life companies neither want nor need the yield insurance assistance.

Senate hearings were short and snappy and mostly given over to hearing people like Franklin D. Roosevelt, Jr., former Mayor La Guardia and Boris Shiskin, A.F. of L. economist who, of course, are all for it. Raymond M. Foley, incidentally, endorsed it, declaring that it "isn't perfect but I believe it would make it possible for this nation to start forward now with the kind of a housing program which has long been needed."

Under the new bill, NHA would become the National Housing Commission, a sort of coordinating agency, with a Coordinating Council consisting of heads or representatives of FHA, FPHA, RFC, Federal Home Loan Bank Board, VA and the secretaries of the treasury and agriculture. Members will note that this is about the same thing which MBA called for in its statement of housing policy last February when we asked for a National Housing Policy Board to consist of essentially the same personnel except that we suggested the secretary of commerce as chairman and didn't include the treasury and agriculture secretaries on the board.

Now that rent de-control has taken the disastrous turn that it has, the Washington spotlight will, as far as the mortgage business is concerned, become increasingly focussed on public housing. The realtors declared it's second on their list with rent control first—which actually means it's first now. Philip Klutznick, former FPHA head, told our Chicago Clinic that housing, and the future of public housing, is likely to be a major issue in the presidential campaign and we have the idea that he may be right.

So the battle lines on public housing are forming. Those with Senator Taft believe, as he told the senate committee, that "private industry has never provided the necessary housing for the low income groups." Thurman Arnold, in a recent issue of *Look,* states the case for the other side when he clearly shows that public housing is simply not the answer for more and better housing.

There are honest differences of opinion in this matter, even among ourselves, as the next article in this issue shows. Mr. Pollak is vice president of Draper & Kramer, Inc., Chicago, one of the leading mortgage and real estate management firms in the country. He states his case well and presents facts which can't be brushed aside. His interest in more and better housing is an active and sincere one. In his home community he participates in the work of the Metropolitan Housing Council, the sort of organization that is making an honest effort to do something constructive in housing.

Let's Pitch in and Help Government Work Out a Better National Housing Program

By MAURICE A. POLLAK

AS MORTGAGE men, realtors and builders have continually opposed public housing, it is interesting to see that one of our leading insurance company executives has the courage to come out in the January issue of *The Mortgage Banker* with a statement that, at current prices, private enterprise does not find the public housing field feasible or possible.*

Maurice A. Pollak

Most of us take pride in our cities and in our contribution to their development and like to feel that we want every American to have a decent place to live. How then can people with any experience in the real estate business maintain that government should stay out of housing on the basis that private industry is well able to provide housing for all? Certainly the builders and the mortgage institutions who have taken advantage of government help in FHA loans should be the last to complain about government subsidies. Certainly these people should know what type of housing is available and at what rents considering today's cost of construction, operation and taxes.

Let's review some of these costs to see what can be made available to the lowest income group to which government housing makes apartments available at $6 to $8 per room:

The cost of building today figures a minimum of $1800 a room, but we will assume that these costs are only temporary and that we will soon be building at $1500 a room.

Ground in Chicago for apartment sites usually costs about $150 a room, making the total cost for ground and building $1650 a room.

Figuring a 100 per cent, 30-year loan at 4 per cent, which would include 3½ per cent mortgage plus ½ per cent mortgage insurance under Title 608, we would have payments of $94.50 per room per year.

*Mr. Pollak's reference is to the statement by George S. Van Schaick of New York Life that, at current prices, private enterprise cannot serve the field which public housing aims to do.

The MORTGAGE BANKER

Published Monthly at 111 West Washington Street, Chicago 2, by the

MORTGAGE BANKERS ASSOCIATION OF AMERICA

Guy T. O. Hollyday *President* · John C. Thompson *Vice President* · George H. Patterson *Secretary-Treasurer* · Miller B. Pennell *General Counsel* · G. H. Knott *Editor*

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MAY, 1947

Our firm is operating over 7000 apartment units in both small buildings and large housing projects. We have a number of apartment projects varying from 75 to 600 apartments and the lowest operating figure is $50 per room. It is my understanding that this figure is a good one for apartment operations in any of the large cities. In Chicago, St. Louis, Minneapolis and St. Paul we have found that taxes figure around $20 a room. While insurance varies as to the kind of fire protection available in the area and the types of construction, an average figure in Chicago would be $4.50 per room on a $1500 per room valuation. The operating figure of $50 a room does not include a replacement reserve, and there are many items on which a reserve should be set up—stoves and refrigerators of course are the most important—but $5 a room has been found to be a very reasonable figure for a reserve. Operations at $50; taxes at $20; insurance at $4.50; replacement reserve of $5; and financing of $94.50 makes a total of $174 per room per year or $14.50 a month. This allows no profit whatever for the promoters, unless they happen to be the builders and make their profit out of the construction without any regard to future operations.

Of course, it is not necessary to give the tenants in public housing the very best service or maintenance. However, most maintenance items outside of decorating are necessary for upkeep of the building, and it is unlikely that operating costs could be greatly reduced on this score. How then, with costs of $14.50 a room, is private industry going to provide housing for those who can afford to pay $6? The sooner that we in our business admit that we are not going to be able to furnish housing for these unfortunates, the quicker this country will have a real housing program. Instead of opposing every public housing move on the part of the government, why don't we realize these facts and try to work with the government in developing some type of subsidy which will make it possible for those people unable to pay an economic rent to have decent housing.

In the past the program of public housing has been developed by the government, not only without any assistance, but with the opposition of real estate and mortgage people. It is reasonable to assume that with our knowledge of the business we should be able to help the government to work out a better program.

SIZES UP CITY LOANS

(Continued from page 4)

installments which may affect his ability to meet his monthly loan payment, rather than to require that a down-payment be made on the property.

Considering G.I. loan terms, lenders are somewhat concerned about loans for the maximum term of 25 years. The low monthly payment required by a 25-year loan may sometimes be desirable from the standpoint of the borrower's income. However, considering his ultimate welfare it would seem that it is also to his advantage to secure a debt-free home as rapidly as is consistent with his circumstances. The more rapidly the repayment of his indebtedness, the greater the savings which he may make on his total interest charges. I do not believe that there have been very many insurance companies willing to make 25-year conventional loans and as a consequence there has been some reluctance to make 25-year G.I. loans even on new properties. The reason for this is probably clear when we consider the percentage of principal repaid in the earlier years of the 25-year term. At the end of a 5-year period, 12.9 per cent of the principal is repaid or an average of only 2.6 per cent per year. At the end of 10 years, 28.7 per cent of the principal is repaid or an average of only 2.9 per cent per year. I believe it is also well to keep the term less than 25 years for another reason. The lender is then afforded an opportunity to reduce the monthly payment should financial difficulties on the part of the veteran make a reduction desirable.

What of the future of the G.I. lending program? I think as time goes on and conditions become more normal in the housing market that most of the valuation problems facing us today will be eliminated. Also, as the veterans grow older and become more permanently established, our credit underwriting problems will be simplified. Insurance companies are purchasing a fair share of the G.I. loans being made today and I believe will continue to do so.

It is very important that an insurance company have a realistic policy for successful operation with mortgage loan correspondents. It is the *body* of any lending program. But something of greater importance in our lending operations is a basis of mutual confidence with the correspondent. This is the *heart* of our relationship. We should strive to build and maintain that basis of mutual confidence.

SEES LOAN SHORTAGE FOR ANOTHER 8 YEARS

(Continued from page 5)

luctant because of present high costs and the uncertainty of profitable return on investment.

Dr. Bussing also indicated that less than 20 per cent of the families in the State would be able to afford new housing during the next eight years, based on present income levels and building costs stabilized as above. The remaining 80 per cent of the people, he believed, would be able to obtain housing relief only through some sort of housing subsidy.

People and Events

At a recent meeting of the Cincinnati Mortgage Bankers Association, members heard John Jordan, Union Central Life, and W. S. Wenzel, Western & Southern, discuss "The Home Office Lending Officer Looks at a Mortgage Loan."

At the recent annual meeting of the Iowa Mortgage Bankers Association, members voted their opposition to the old Wagner-Ellender-Taft bill and went on record as opposed to the mortgage registration tax proposed for that state. Under this legislation, a tax of 15c per each $100 principal of mortgage debt or obligation would be levied.

Ferd Kramer, president, Draper & Kramer, Inc., Chicago, was elected president of Chicago's Metropolitan Housing Council for the fifth consecutive term. Walter L. Cohrs, vice president, First National Bank of Chicago, was named treasurer.

CARL BURRELL NEW HEAD SOUTHERN CALIFORNIA MBA

Carl F. Burrell was elected president of the Southern California Mortgage Bankers Association at the annual meeting to succeed T. S. Burnett, and R. D. Burrows was named vice president. Ralph W. Jenkins was elected secretary. New directors include the officers and George W. Elkins, John D. Engle, P. M. Leishman, Gordon Stimson, Henry A. Dutcher and Mr. Burnett.

L. Douglas Meredith, executive vice president of the National Life Insurance Company of Vermont, was the principal speaker at the dinner and discussed ways and means of improving mortgage lending practices and procedure.

Relatively few changes in real estate lending practices have been introduced in the past, he said, and it was not until the thirties that some of the industry's weaknesses became glaringly apparent.

Present highly competitive conditions are forcing lenders to devise better means of marketing their product but a few are resorting to the "easy way" of paying finders fees and making higher percentage loans, both of which prove, in the long run, to be unprofitable, he declared.

He recounted the original opposition to FHA and then described his own company's excellent experience with FHA's. Mr. Meredith also described the "packaged mortgage" which his firm is making.

Appraisal Standard for Measuring Value

By ROLAND A. BENGE
of The Detroit Bank

BACK in 1935, when I entered the real estate loan department in my bank, we found there had been no accurate information prepared so that when an appraisal was made, we could relate the value of that appraisal to any other particular period in the past. It was our feeling that appraisals were fundamentally the basis of a good mortgage loan, and the basis of a sound lending policy.

Judgment of values in real estate depends upon information. To safeguard against overly optimistic appraisals and correspondingly poorer loans, it is necessary to have some sort of appraisal control. There should be a fair standard set with which to measure values.

At that time, taking 1936 as a normal year with respect to costs and land values, we established such a control. We chose an average home under construction at the time. This "selected standard home" is a house in the average price class, in a good American neighborhood, built of good materials and better than average workmanship. It is a two-story brick veneer single dwelling 27x35.6 over all, with a full basement, which contains a recreation room, laundry tubs and air conditioning unit. The house has a good architectural layout.

Periodically, at least once each six months, we make a detailed appraisal of the cost of reproducing this building, which appraisal reflects the change, if any, in the land valuation. We estimated as nearly as we could the reproduction cost of this property from 1940 to 1945 and have charted this information.

Because the construction of this type of house has been forbidden since 1941, we are not able to prove our cost figures for the past four years, but we are sure that they are reasonably accurate. By drawing an average, we have determined what the cost of this type of building should be in a normal year, and have created a base accordingly. From this base we are in a position to determine how much above or below the normal cost our appraisals can be allowed to fluctuate before they become dangerously high or low, and in that way we are able to expand or contract our policies accordingly.

In the 1920s it was not unusual for the land on which a house was built to be valued at or nearly as much or more than the residence erected on it. As a defense against a recurrence of this phenomenon, it is well to limit land valuations to a predetermined percentage of the total valuation of land buildings of a residential nature.

Thus we have a basis for comparison of current costs against a normal year. Quite often much effort is consumed in making analyses and comparisons merely for the sake of a comparison, which cannot be used after the effort is expended. One caution to be observed is that conditions may change rapidly, and figures or measuring charts do not possess the measuring value they once had. Above all, decisions cannot be based on figures that do not represent the same conditions today that they did when they were compiled. To be effective, there must be a yardstick by which to measure — a standard with which to compare.

Past experience has shown that one of the most frequent mistakes in connection with lending policies with respect to commercial properties has been that appraisals were based on actual costs, and credit extended on the basis of that cost. The mistake was that lenders failed to take into consideration the more or less special purpose nature of many of these buildings and the almost prohibitive cost of alterations. Lenders should never make a mortgage, if they feel there is a great possibility that they will have to foreclose, but it is always a possibility that cannot be overlooked in any analysis. Consequently, loans made on this type of property should be studied from the standpoint of their resale possibility.